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TAGS: EFIN ECON EINV PREL LO
SUBJECT: SLOVAKIA'S BUDGET SEASON BEGINS

REF: BRATISLAVA 316, BRATISLAVA 413

SUMMARY

¶1. (U) The draft 2010 budget was approved by the Slovak Cabinet on 30 September; it now goes forward to further negotiation before passage in final form at year end. The budget reduces the deficit to 5.5% of GDP through a series of spending cuts aimed at ministries that do not directly touch the public, most notably the defense ministry. At the same time, social and infrastructure spending increase, and overall spending increases 15%.

¶2. (SBU) We expect most of the real negotiation to occur among the three coalition partners, despite the weak bargaining position of the two junior partners. This means the final budget will reflect political expediency--a division of spoils among competing fiefdoms--more than government priorities. Still, the deficit reduction ambitions appear to be real, and the Ministry of Finance is preparing some revenue-side measures to help bring the deficit down to 3% by 2012. End summary.

The Road of Blood and Sweat

¶3. (SBU) After months of hedging on a budget revision for 2009 (ref A), and unusual silence during the drafting of next year's budget, Finance Minister Jan Pociatek finally submitted a draft to the government on September 30. The Cabinet approved the draft on the same day, and the bill now moves to behind-the-scenes negotiations leading up to the required three readings in Parliament. The budget delivers deep cuts in virtually every ministry that does not directly touch the public and hefty increases for those that do. Ministry of Finance State Secretary Peter Kazimir described the budget as a "road of blood and sweat," following on months of promises from Pociatek and other senior officials that the budget would be ambitious on consolidation.

¶4. (U) The big losers are the ministries of defense (down 21% from 2009), foreign affairs (18%), interior (10%), and culture (10%). The biggest loser proportionally is, interestingly, the Constitutional Court, with a nearly lethal 49% reduction in its meager EUR 5.7 million budget (ref B). The winners are the ministries of agriculture (up 19%), construction (29%), health (10%), and education (8%). Again, these priorities reflect PM Robert Fico's long-standing pledge to cut the deficit aggressively while augmenting--or at least not cutting--social services. In addition to the ministry-by-ministry cuts, there is rumored to be an across-the-board mandate to cut purchases of outside goods and services by 20% and capital expenditures by 70%.

¶5. (U) If the bottom line holds through negotiations, the deficit would drop from 2009's projected 6.3% of GDP (EUR 4 billion) to 5.5% (EUR 3.7 billion)--an ambitious cut indeed in a year when unemployment is expected to creep up from today's 11% to 13.5%. The total budget is EUR 16.3 billion, a 15% increase in spending over this year's EUR 14.1 billion.

A Serious Proposal?

¶6. (SBU) The main question now is whether the draft is a realistic budget or simply an exaggerated opening position for horse-trading to come. The way the Ministry of Finance (MoF) has chosen to handle the political run-up to the formal budget submission suggests the latter. Before the formal submission, the government is supposed to consult in detail with the "tripartite," a group comprising government, labor unions, and employers. This year, the MoF circulated a single-page spreadsheet to the tripartite a couple of hours before the scheduled consultation. Both the employers and the unions (the latter being a strong Fico constituency) complained bitterly that negotiating was impossible given so little information so late.

¶7. (SBU) Most of the battle over budget priorities--if there is a battle--will not happen between the opposition and the governing coalition. Once the coalition has agreed, party discipline will prevail, and the vote will be a pro-forma exercise. The real contest will be among coalition members, who tend to view their ministries as fiefdoms to be run for political and material profit. The minority SNS and HZDS, both of which are unabashedly corrupt, know the coalition is drawing

to a close. (The final budget is due on the day the coalition agreement expires, and passage of a pre-election budget is usually seen as the last act of Slovak coalitions.) They will certainly want to lock in their revenue opportunities by fighting for the biggest possible slices of the budget pie. As we understand it, the important conversations in budget negotiations are among party leaders rather than Cabinet ministers, so the final allocation of funds is likely to reflect political expediency more than social priorities. Given the recent public disagreements among the three coalition leaders, there could be a fight.

Puzzling but Real Fiscal Conservatism

¶8. (SBU) Advisors in the MoF have told us that both Pociatek and Fico really do want to drop the deficit now and in out-years, with the goal being to achieve a 3.0% deficit in 2012. This goal may seem strange coming from an emphatically "socially oriented" Prime Minister. We understand that his fiscal conservatism is based on the belief that, euro adoption notwithstanding, financial markets will deal Slovakia swift and severe punishment at the first sign of profligacy. This belief is nearly universal in Bratislava, despite the fact that this year's refinancing exercise produced the lowest rates in Slovakia's brief history (less than 200 basis points above Germany).

¶9. (SBU) The deficit reduction in the 2010 budget derives entirely from reconfiguring expenses. The MoF is trying to develop a couple of revenue aces in the hole for 2011, some of which may be possible to achieve in 2010. One is a streamlining of tax administration to a single agency and possibly pulling some health insurance contributions into the tax system, which would involve raising the flat tax from the current 19%. Another measure may be to reduce the contribution ceiling to the second (private) pension pillar, which would force more social contributions into the money-losing first pillar. Finally, a hike in property taxes is being considered, probably in the form

of a revised assessment basis.

COMMENT

¶10. (SBU) It is hard to know how the budget conversation will proceed among the members of a distinctly cracked coalition. Vladimir Meciar's HZDS is widely thought to be moribund already, with little chance of breaking the 5% floor to win seats in Parliament. Fico has openly broken with SNS, taking two senior positions away from the party in recent months and saying that he no longer cares whether the coalition agreement holds. This leaves both minority partners with almost nothing to bargain with and nothing to lose. Still, although Fico shows signs of viewing his partners as disposable, he needs to keep his government from blowing up as the 2010 election approaches, and the partners know it. So deals will be struck, and the budget will likely look less severe, though not necessarily more rational, by the end of the year.
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